UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT SEATTLE

HENRY CHILDRESS, *et al.*,

Plaintiffs,

v.

LIBERTY MUTUAL FIRE INSURANCE COMPANY, *et al.*,

Defendants.

Case No. C10-059RSL

ORDER REGARDING CROSS MOTIONS FOR SUMMARY JUDGMENT

I. INTRODUCTION

This matter comes before the Court on a motion for summary judgment filed by defendant Liberty Mutual Fire Insurance Company ("Liberty Mutual") and a cross motion for partial summary judgment filed by plaintiffs Henry and Deborah Childress. Liberty Mutual seeks to dismiss all of plaintiffs' claims, and plaintiffs seek summary judgment on their claim that Liberty Mutual breached their insurance contract by attempting to unilaterally add additional coverage to plaintiffs' homeowners policy, then cancelling the policy when plaintiffs failed to pay for the additional coverage. At the parties' request, the Court heard oral argument in this

matter on February 3, 2011.[1]

For the reasons set forth below, the Court grants plaintiffs' motion and denies Liberty Mutual's motion.

II. DISCUSSION

A. Background Facts.

On January 1, 2008, Henry Childress spoke with a Liberty Mutual sales representative to purchase a homeowners policy of insurance. Based on the telephone conversation and the information Mr. Childress provided, Liberty Mutual generated and provided a quote of $1,424.00 per month. On that day, Liberty Mutual e-mailed Mr. Childress several documents, including an application form and an earthquake coverage form. The cover letter stated that he was required to complete and return all forms "[t]o guarantee that you receive uninterrupted coverage" and that the earthquake coverage form was "Required to validate rating variables and other pertinent information." Declaration of Carla Crick, (Dkt. #49-1) ("Crick Decl."), Ex. 2. The top of the earthquake coverage form, in all capital letters, stated, "Your policy does not include coverage against the peril of earthquake." Id. Underneath was the following language, "Earthquake coverage, subject to policy provisions, may be purchased for an additional premium. If the coverage is selected and premium paid, we will insure for direct physical loss to property covered under Section 1 caused by earthquake . . . ." Id. The page listed available earthquake deductibles and stated, "If coverage is being requested, please select a deductible option from those listed above." Id. Liberty Mutual placed an "x" in the box next to the statement, "I reject Earthquake coverage." Id. The sales representative who spoke with Mr. Childress on that day has filed a declaration stating that the inclusion of the earthquake form in the package "confirms that I discussed this form with the customer, was advised that the

[1] Plaintiffs have also sued additional defendants who are not parties to these cross motions: Meritplan Insurance Company, Countrywide Home Loans, Inc., BAC Home Loans Servicing, LP, and Bank of America, N.A.

customer rejected this coverage and that I advised him that he needed to return the signed rejection of earthquake coverage with the application within ten days for the rejection to be effective." Crick Decl. at ¶ 6. Mr. Childress states that he asked for "basic" coverage over the phone and does not recall any discussion of earthquake coverage. Childress Dep. at p. 65.

The next day, Liberty Mutual mailed to plaintiffs a copy of the policy, a policy declarations page showing the initial premium due, and another copy of the earthquake coverage form. Declaration of Robin Smith, (Dkt. #32) ("Smith Decl."), Ex. 2. The cover letter stated, "Your homeowners policy is enclosed. It describes the coverage you selected . . . ." Id. The policy was effective as of January 2, 2008 and it excluded earthquake coverage. Meitler Dep. at pp. 35-36. Defendant Countrywide Home Loans, plaintiffs' mortgagee, paid the initial premium on or around January 14, 2008, and Liberty Mutual accepted the payment.

Liberty Mutual has an internal policy requiring a signed application that specifically selects or rejects earthquake coverage to avoid misunderstandings regarding the scope of coverage. Declaration of Robbie Meitler, (Dkt. #30) ("Meitler Decl.") at ¶ 4. On February 19, 2008, the policy came up for review. At that time, plaintiffs had not submitted a signed application or a written declination of earthquake coverage. Liberty Mutual sent a "courtesy" e-mail to Mr. Childress stating, "As of today, we have not received the signed application forms back in our office. We do need to receive the signed forms back within 5 business days or your coverage will increase in accordance with state insurance regulations." Smith Decl., Ex. 5. Mr. Childress did not return either document because he thought it was a "scam." Declaration of Henry Childress, (Dkt. #26-2) ("Henry Childress Decl.") at ¶ 8. Because the signed forms were not returned, on February 29, 2008, Liberty Mutual issued an endorsement that added earthquake coverage to the policy and provided notice of the addition to plaintiffs. Smith Decl. at ¶ 6, Ex. 6 (noting a premium increase of $353.00 as a result of the additional coverage). On the same day, Liberty Mutual e-mailed Mr. Childress a copy of the policy application and another copy of the earthquake form with a check next to the box stating, "I reject earthquake coverage." Id., Ex. 8.

Mr. Childress did not sign or return the form.

On or around March 3, 2008 and again on April 2, 2008, Liberty Mutual generated and mailed premium notices to plaintiffs for the earthquake premium, reflected in the notices as "new policy balance" and "Endorsement 01." Smith Decl., Exs. 9, 10. The notices also stated that payment was required to ensure uninterrupted coverage. After receiving the second notice, Mr. Childress called Liberty Mutual to question why he was being billed for earthquake coverage. He was informed that the coverage was added because he failed to return the signed application and signed earthquake coverage declination form. Smith Decl. at ¶ 11. Although Liberty Mutual sent him duplicate forms at his request, he did not sign them and return them to Liberty Mutual. Subsequently, monthly premium invoices were generated and mailed to plaintiffs for May to September 2008. Plaintiffs did not pay the outstanding premium, return the signed forms, or contact Liberty Mutual again. Mr. Childress believed that because he had paid the annual premium in advance to Countrywide, which was copied on all of the notices, that Countrywide would respond and make the payments. Henry Childress Decl. at ¶ 10.

On September 25, 2008, Liberty Mutual's automated system generated a cancellation notice that was issued to plaintiffs cancelling their policy for nonpayment of the earthquake premium effective October 10, 2008 unless they paid the current amount due. Smith Decl., Ex. 13. Plaintiffs did not pay the allegedly outstanding premium or contact the company. Their policy was cancelled effective October 10, 2008 for nonpayment of the earthquake premium.[2]

Thereafter, plaintiffs suffered a devastating home fire on December 21, 2008. Liberty Mutual refused to pay for the loss because its policy was no longer in effect. The policy states that it may be cancelled for nonpayment: "When you have not paid the premium we may cancel at any time by notifying you at least 10 days before the date cancellation takes effect." Smith

[2] After the Liberty Mutual policy was cancelled, Countrywide obtained a lender placed policy for the home to protect its security interest. Declaration of Sarah Eversole, (Dkt. #29) Ex. 3.

Decl., Ex. 3 at p. 18 of 19.

Plaintiffs originally filed this case in King County Superior Court, and defendants removed it to this Court in January 2010 based on diversity jurisdiction. Plaintiffs assert claims for breach of contract, bad faith, negligence,[3] and violations of Washington's Administrative Code and Consumer Protection Act.

B. Summary Judgment Standard.

Summary judgment is appropriate when, viewing the facts in the light most favorable to the nonmoving party, the records show that "there is no genuine issue as to any material fact and that the movant is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(a). Once the moving party has satisfied its burden, it is entitled to summary judgment if the non-moving party fails to designate, by affidavits, depositions, answers to interrogatories, or admissions on file, "specific facts showing that there is a genuine issue for trial." Celotex Corp. v. Catrett, 477 U.S. 317, 324 (1986).

All reasonable inferences supported by the evidence are to be drawn in favor of the nonmoving party. See Villiarimo v. Aloha Island Air, Inc., 281 F.3d 1054, 1061 (9th Cir. 2002). "[I]f a rational trier of fact might resolve the issues in favor of the nonmoving party, summary judgment must be denied." T.W. Elec. Serv., Inc. v. Pacific Elec. Contractors Ass'n, 809 F.2d 626, 631 (9th Cir. 1987). "The mere existence of a scintilla of evidence in support of the non-moving party's position is not sufficient." Triton Energy Corp. v. Square D Co., 68 F.3d 1216, 1221 (9th Cir. 1995). "[S]ummary judgment should be granted where the nonmoving party fails to offer evidence from which a reasonable jury could return a verdict in its favor." Id. at 1221.

C. Analysis.

Because the Court's jurisdiction is based on diversity, it applies Washington law. See,

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[3] The parties' memoranda do not address the negligence claim, so that claim is not currently before the Court.

e.g., Jorgensen v. Cassidy, 320 F.3d 906, 914 (9th Cir. 2003). Under Washington law, summary judgment is proper where the decision turns on the interpretation of an insurance policy, which is a question of law. See, e.g., Allstate Ins. Co. v. Peasley, 131 Wn.2d 420, 423-24 (1997).

1. Breach of Contract Claim.

Pursuant to the terms of the policy, Liberty Mutual was permitted to cancel it "only for the reasons stated below." Policy at p. 18. One of those listed reasons is nonpayment of premium. It is undisputed that plaintiffs paid the premiums for the basic coverage they requested. Liberty Mutual's contention that it properly cancelled the policy for nonpayment of the earthquake premium begs the question of whether the earthquake premium was actually due. Liberty Mutual contends that its representative informed Mr. Childress during his initial telephone call that the company required a signed earthquake coverage declination form to waive coverage, so that term was part of the offer of insurance. That term, however, was not made a part of the contract, which was effective January 2, 2008. Liberty Mutual admits that it issued plaintiffs a policy without earthquake coverage. Meitler Dep. at pp. 35-36. In Washington, an insurance policy must contain the entire contract. RCW 48.18.190 ("No agreement in conflict with, modifying, or extending any contract of insurance shall be valid unless in writing and made a part of the policy."). An insurer is bound by the premium rate stated in the policy and may not alter it mid-term absent certain conditions not present in this case. RCW 48.18.180(1) & (2); WAC 284-30-590(2). A telephone conversation cannot alter the terms of the policy where it was not made a part of the policy. National Indem. Co. v. Smith-Gandy, Inc., 50 Wn.2d 124 (1957) (finding that "the telephone conversation and the letter of confirmation did not change the terms of the policy subsequently issued."). Therefore, Ms. Crick's conversation with Mr. Childress did not alter the terms of the policy. Nothing in the policy or application stated that Liberty Mutual could or would add earthquake coverage and correspondingly increase plaintiffs' premium if they failed to return the form. Even if extrinsic evidence could be used to alter the policy's terms, the January 1 and 2, 2008 letters upon which

Liberty Mutual relies do not warn of a premium increase. Instead, those letters stated that failure to return the earthquake form could result in cancellation of coverage. The company's subsequent cancellation of the policy was not due to the failure to return the forms; it was due to the nonpayment of the earthquake premium. Although the effect of cancellation was the same, the legal import is not. Quite simply, neither the policy nor applicable law permitted Liberty Mutual to unilaterally add the previously declined earthquake coverage and increase the premium as they did in this case.[4] Liberty Mutual therefore breached the contract.

Although the case law is scant, the Washington Supreme Court has held that a cancellation of an insurance policy must "be in accordance with the provisions of the policy to be effective." Blomquist v. Grays Harbor County Med. Serv. Corp., 48 Wn.2d 718, 721 (1956) (quoted in Olivine Corp. v. United Capitol Ins. Co., 147 Wn.2d 148 (2002) (holding that the insurer's failure to follow statutory notice provisions left the policy in effect)); see also Franklin v. Northern Life Ins. Co., 4 Wn.2d 541 (1940) (explaining that when an insurer wrongfully cancels a policy, the insured may recover its value, have the policy adjudged in force, or tender premiums and if refused, wait until the policy becomes payable and test forfeiture in a proper action). Because the cancellation in this case was not in accordance with the policy or with applicable law, it was ineffective. Accordingly, it remained in effect when plaintiffs suffered their loss. The Court therefore grants summary judgment in plaintiffs' favor on their breach of contract claim.

[4] Liberty Mutual also alleges that plaintiffs accepted the benefit of the earthquake coverage and were therefore bound to pay for it. Liberty Mutual's Reply at p. 11 (citing Restatement Second, Contracts § 69(3)) (stating inaction can constitute acceptance of an offer where "an offeree takes the benefit of offered services with reasonable opportunity to reject them and reason to know that they were offered with the expectation of compensation."). There is no authority for applying that provision in the insurance context, where a clear statute requires all terms to be contained in the policy. Even if it were applicable, plaintiffs never made a claim for earthquake coverage or otherwise accepted its benefits.

2. Consumer Protection Act and Bad Faith Claims.

Liberty Mutual contends that plaintiffs cannot establish any of the five elements necessary to state a CPA claim: (1) an unfair or deceptive act or practice, (2) in trade or commerce, (3) that impacts the public interest, (4) which causes injury to a party in his business or property, and (5) which injury is causally linked to the unfair or deceptive act. Hangman Ridge Training Stables, Inc. v. Liberty Title Ins. Co., 105 Wn.2d 778, 784-85 (1986). By statute, the "business of insurance is one affected by the public interest," RCW 48.01.030, so the third element is met. The second element is also met because the practices at issues occurred in trade or commerce. Although Liberty Mutual argues that plaintiffs have not suffered damages, they have sufficiently demonstrated that the uninsured damage to their home constitutes an injury to support their CPA and bad faith claims.

Plaintiffs contend that Liberty Mutual violated WAC 284-30-330(4)[5] by "[r]efusing to pay claims without conducting a reasonable investigation." Plaintiff argue that a reasonable investigation would have shown that plaintiffs had prepaid their annual premium "and that the cancellation was the result of earthquake coverage being imposed without their consent." Plaintiffs' Cross Motion at p. 22. The regulation, however, contemplates a reasonable factual investigation, which plaintiffs do not address. Plaintiffs' claim is premised on defendant's wrongful premium increase, not an inadequate factual investigation. Therefore, the regulation is inapplicable.

Plaintiffs also argue that Liberty Mutual violated WAC 284-30-590(2), and the violation constitutes a per se unfair trade practice violation for purposes of the CPA. That regulation provides, "In the unusual situation where a contract permits a midterm change of rates or terms,

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[5] Plaintiffs also contend that Liberty Mutual violated the Insurance Fair Conduct Act ("IFCA") by violating the insurance regulations. The Court denied plaintiffs' belated request to amend their complaint to add an IFCA claim. Even if that claim were properly asserted, it would fail. Plaintiffs premise their IFCA claim on defendant's alleged failure to comply with WAC 284-30-330 and WAC 284-30-590(2), but they have not shown a violation of either provision.

other than in connection with a renewal, it is an unfair practice to effectuate such change with less than forty-five days advance written notice to the named insured, or to utilize a contract provision which is not set forth conspicuously in the contract under an appropriate caption of sufficient prominence that it will not be minimized or rendered obscure." That regulation, however, is inapplicable because, as plaintiffs contend, the policy does not permit a midterm change or rates or terms.

Instead, Liberty Mutual violated RCW 48.18.180(1) and (2), which provide:

> (1) The premium stated in the policy shall be inclusive of all fees, charges, premiums, or other consideration charged for the insurance or for the procurement thereof.
>
> (2) No insurer or its officer, employee, appointed insurance producer, or other representative shall charge or receive any fee, compensation, or consideration for insurance which is not included in the premium specified in the policy.

In this case, Liberty Mutual charged plaintiffs for an additional premium that was not included in the premium set forth in the policy. In fact, until it billed plaintiffs for the earthquake coverage, Liberty Mutual never informed them of the amount of such coverage. A violation of the statute, however, does not constitute a per se unfair or deceptive trade practice. For that reason, plaintiffs must show that Liberty Mutual's conduct has the capacity to deceive a substantial portion of the public. Hangman, 105 Wn.2d at 785. That issue presents an issue of fact. Id. at 789-90; Holiday Resort Cmty. Ass'n v. Echo Lake Assocs., LLC, 134 Wn. App. 210, 226-27 (2006). Although Liberty Mutual states that its forms, letters, and e-mail clearly informed plaintiffs that a failure to return the form would result in the addition of coverage and premium increase, a review of the actual documents reveals otherwise. In fact, the earthquake form itself clearly states that the coverage had been declined and explained how it could be added. Moreover, the e-mail Liberty Mutual sent to plaintiffs threatened a rate increase "in accordance with state insurance regulations," suggesting to the recipient that Liberty Mutual's actions were compelled by state law, when in fact they were contrary to law. Smith Decl., Ex. 5. A jury could find for plaintiffs on the capacity to deceive issue because Liberty Mutual's conduct in this case reflects its standard practices, not just isolated conduct. Meitler Decl. at ¶ 4; Meitler Dep.

at pp. 26-31. A jury must also decide whether plaintiffs' damages are the result of Liberty Mutual's conduct or their own failure to sign and return the forms despite repeated requests. Therefore, Liberty Mutual's motion for summary judgment on plaintiffs' CPA claim is denied.

The Washington Supreme Court has declared that insurers have a duty of good faith to their policyholders "and to succeed on a bad faith claim, a policyholder must show the insurer's breach of the insurance contract was unreasonable, frivolous, or unfounded." Smith v. Liberty Ins. Co., 150 Wn.2d 478 (2003). The determination of reasonableness must be made in light of all the facts and circumstances of a particular case. See, e.g., Anderson v. State Farm Mut. Ins. Co., 101 Wn. App. 323, 329-30 (2000). "[A]n insurer must deal fairly with an insured, giving equal consideration in all matters to the insured's interests." Tank v. State Farm Fire & Cas. Co., 105 Wn.2d 381, 385-86 (1986). In light of that duty, an insurer acts in bad faith when it "overemphasizes its own interests." Anderson v. State Farm Mut. Ins. Co., 101 Wn. App. 323, 329 (2000) (citation omitted). In this case, Liberty Mutual unilaterally added, and billed plaintiffs for, earthquake coverage that it admits they expressly declined. They did so to protect themselves from a later claim that plaintiffs had such insurance. Meitler Dep. at pp. 26-27 (explaining that Washington shows a "significant earthquake risk" and "the company is at risk without getting something signed from [insureds] that they are rejecting the coverage."). Liberty Mutual's representative further explained why the company requires a signed declination form, even though it is not required under Washington law:

> There is a court system that could rule against any – you know, we wanted the extra protection to have the signed form, of our worry of losing if there is an earthquake, if Mr. Childress – if there was an earthquake post him not returning the rejection form, would we be able to defend that and be able to exclude earthquake from his policy? Our determination was we are in a better – we are in a better company position to either obtain the rejection form or add the coverage.

Meitler Dep. at 28. Based on that testimony and the facts of this case, a reasonable jury could conclude that Liberty Mutual acted unreasonably by placing its own pecuniary and risk-avoidance interests above the interests of its insured. Therefore, Liberty Mutual's motion for summary judgment on the bad faith claim is denied.

III. CONCLUSION

For all of the foregoing reasons, the Court DENIES Liberty Mutual's motion for summary judgment (Dkt. #27) and GRANTS plaintiffs' motion for partial summary judgment regarding liability on their breach of contract claim (Dkt. #44). The remaining issues include plaintiffs' CPA and bad faith claims and the amount of damages related to plaintiffs' breach of contract claim. The parties are directed to attempt settlement with the guidance given by the Court in this order and during oral argument.

DATED this 7th day of February, 2011.

Robert S. Lasnik
United States District Judge